



HOUSE OF COMMONS
CHAMBRE DES COMMUNES
CANADA

Standing Committee on Finance

FINA • NUMBER 115 • 1st SESSION • 41st PARLIAMENT

EVIDENCE

Tuesday, April 23, 2013

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Chair

Mr. James Rajotte

Standing Committee on Finance

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•(0845)

[English]

The Chair (Mr. James Rajotte (Edmonton—Leduc, CPC)): Good morning, everyone. This is meeting number 115 of the Standing Committee on Finance.

The orders of the day are pursuant to Standing Order 108(2), a study on the report of the Bank of Canada on monetary policy.

Ms. Nash, you wanted to start the meeting.

Ms. Peggy Nash (Parkdale—High Park, NDP): Thank you, Mr. Chair.

I have a question about the agenda. I sent you a note asking about the Parliamentary Budget Officer, and whether she'll be joining us in the fourth week of April, as she's mandated to do by this committee.

The Chair: I was going to deal with that in the subcommittee.

Can we deal with that in the subcommittee?

Ms. Peggy Nash: All right.

The Chair: The subcommittee is meeting immediately after this meeting.

Thank you

Everyone, we are very pleased to welcome back to the finance committee the Governor of the Bank of Canada, Mr. Mark Carney, at his final appearance before our committee.

Welcome back to the committee, Mr. Carney.

We're also very pleased to welcome back to the committee his senior Deputy Governor, Mr. Tiff Macklem.

Welcome to both of you, gentlemen. Thank you so much for being with us here this morning.

Mr. Carney, I know you have an opening statement and observations for the committee, and then we'll have questions from all the members.

Please begin your statement now.

Mr. Mark Carney (Governor, Bank of Canada): Thank you very much, Chair.

Tiff and I are very pleased to be with you this morning to discuss our April monetary policy report, which the bank published last week.

I should say at the outset that sessions such as these are an important part of the bank's accountability to Parliament and,

through Parliament, our accountability to Canadians. We greatly appreciate members taking the time and the focus to drill down on our views on what's happening in the Canadian economy and what the prospects are for the global and Canadian economies.

In the report we note that global economic growth has evolved broadly, as anticipated in January. In the United States, the economic expansion is continuing at a modest pace, with gradually strengthening private demand partly offset by accelerated fiscal consolidation.

[Translation]

Significant policy stimulus has been introduced in Japan.

Europe, in contrast, remains in recession, with economic activity constrained by fiscal austerity, low confidence and tight credit conditions.

After picking up to very strong rates in the second half of 2012, growth in China has eased.

Commodity prices received by Canadian producers remain elevated by historical standards, and despite recent volatility, overall they are little changed since January.

•(0850)

[English]

The bank expects global economic activity to grow modestly in 2013 before strengthening over the following two years. Following a weak second half last year, growth in Canada is projected to regain some momentum through 2013 as net exports pick up and business investment returns to more solid growth.

Consumer spending is expected to grow at a moderate pace over the projection horizon, while residential investment declines further from historically high levels. Growth in total household credit has slowed, and the bank continues to expect that the household debt-to-income ratio will stabilize near current levels.

Despite the projected recovery in exports, they're likely to remain at their pre-recession peak until the second half of 2014, owing to restrained foreign demand and ongoing competitiveness challenges, including the persistent strength of the Canadian dollar.

On a quarterly basis, growth in Canada is expected to pick up to about 2.5% in the second half of this year. Despite this expected rebound, with the weak growth in the second half of last year, annual average growth is projected to be 1.5% in 2013.

The economy is then projected to grow by 2.8% in 2014 and 2.7% in 2015, reaching full capacity by the middle of 2015. This is later than the bank had expected in January.

Total CPI and core inflation have remained low in recent months, broadly in line with our expectations in January. Muted core inflation reflects material excess supply in the economy, heightened competitive pressures in the retail sector, and some special factors.

Total CPI inflation has been restrained by low core inflation and declining mortgage interest costs, with some offset from higher gasoline prices.

Both total and core inflation are expected to remain subdued in coming quarters before gradually rising to 2% by mid-2015, as the economy returns to full capacity, special factors subside, and inflation expectations remain well anchored.

[Translation]

The inflation outlook in Canada is subject to upside and downside risks, which are similar to those identified in January.

The three main upside risks relate to the possibility of stronger-than-expected growth in the United States and global economies, a sharper-than-expected rebound in Canadian exports, and renewed momentum in Canadian residential investment.

The three main downsized risks related to the European crisis, more protracted weakness in business investment and exports in Canada, and the possibility that growth in Canadian household spending could be weaker.

Overall, the bank judges that the risks are roughly balanced over the projection horizon.

[English]

Reflecting all of the factors I've listed, on April 17 the bank maintained the target for the overnight rate at 1%, and with continued slack in the Canadian economy, the muted outlook for inflation and the constructive evolution of imbalances in the household sector, the considerable monetary policy stimulus currently in place will likely remain appropriate for a period of time, after which some modest withdrawal will likely be required consistent with achieving the 2% inflation target.

With that, Chair, Tiff and I would be very pleased to take your questions.

The Chair: Thank you very much, Mr. Carney, for your opening presentation.

We'll begin members' questions with Ms. Nash, please.

Ms. Peggy Nash: Thank you, and good morning to both of you. It's a pleasure to have you back here once again.

I have three areas that I'd quickly like to ask about. First, around our inflation target, both the IMF and the Bank of Canada have downgraded growth forecast for 2013 to 1.5%. Despite this, and despite the fact that inflation in the last several months has come in at only 1%, the bank has said it won't lower its target interest rate. I want to ask about that. Is it correct that your concern is over record-high levels of household debt that's discouraging further action despite the sluggishness of our economy?

• (0855)

Mr. Mark Carney: There are two factors that are influencing the setting of monetary policy. First, we are anchored on the inflation target, so we're trying to determine the right path to return the Canadian economy and inflation in Canada to that 2% inflation target. Our current expectation is that in about nine quarters—so a little more than two years—the economy will return to full capacity and inflation will return to the 2% target.

The reason we expect that is that financial conditions, very much as a consequence of monetary policy but also of other factors—the influence of global financial conditions—are very stimulative in Canada, so borrowing rates for Canadian corporations are at all-time lows, borrowing rates for Canadian households are highly attractive, and the currency has come off a bit, which provides a little more stimulus on the margin for the Canadian economy. So those factors, as a whole, are providing a considerable amount of stimulus, which, in our view, will bring the economy back on a reasonable path, in a reasonable horizon, back to target. As well, if I may point out, our expectation is that from the middle of this year the Canadian economy will be growing at a rate above potential.

To the second part of your question—I'll be quick—reflecting the housing sector and the evolution of household imbalances, on the margin we do take into account what is happening in the household sector, and on the margin that influences policy to be less loose, if I can put it that way, than it otherwise would be.

Ms. Peggy Nash: You've expressed concern about household debt in the past.

Mr. Mark Carney: We have expressed a concern. We supported the moves taken by the government, by OSFI, to help with constructive evolution. We're encouraged by the direction of household imbalances. We think monetary policy has played a supportive role in that constructive evolution.

Ms. Peggy Nash: To follow up on the whole issue of mortgage debt and interest rates, the finance minister recently instructed his staff to contact the banks that were offering interest rates below 2.99% to instruct them not to do so. Is it a concern, and is this the role of the finance minister, to call the shots with the interest rates of the banks?

Mr. Mark Carney: In terms of responsibilities for the evolution of household imbalances, obviously, first and foremost, the responsibilities rest with the individuals. People should take on debts that they think they can service over the lifetime of the loan. Canadians are responsible people, and we certainly rely on them to do that.

Institutions have a responsibility as well to ensure that the products they are offering are consistent with the constructive evolution and the ability for the borrowers to service those loans. I would say that as a whole we are encouraged.

I'll give you one fact. About this time last year, when the bank and the government started to take additional steps, the amount of floating rate debt, floating rate mortgages, that Canadians have taken on had fallen from about two-thirds of all mortgages that were being written at the time to about 10%.

Ms. Peggy Nash: Should the minister be making that kind of call to the banks?

Mr. Mark Carney: That's a discussion, obviously, with the minister.

Ms. Peggy Nash: I have one last quick question. The government has raised the general preferential tariff on 72 countries, which will increase the cost to consumers on a whole range of consumer goods. Is it a good time to do this, when consumers are already facing record-high debt and unemployment is still high?

The Chair: Our time for this round is up. I don't know if the opposition wishes to come back to that in a future round—unless the governor can answer that in about 10 seconds, but I suspect not.

Mr. Mark Carney: I would be happy to have a broader discussion. I'd only note that price gaps between Canada and the U.S. have actually fallen over the course of the last two years, from the high teens to about 8% at the moment, on our current measurements.

The Chair: Thank you.

Thank you, Ms. Nash.

Ms. McLeod, please.

Mrs. Cathy McLeod (Kamloops—Thompson—Cariboo, CPC): Thank you, Mr. Chair.

I want to thank you, Governor, for all of the excellent work you've done for Canada, and I wish you well in your new endeavours.

I just want to make a quick comment. It's important to note that we have actually removed preferential tariffs; we haven't raised a tariff. I just wanted to make that comment.

I have one question coming out of your presentation, and then I hope to delve into another area. You're talking about three main downside risks in terms of the Canadian economy. You talk about the possibility that spending by Canadian households could be weaker. Are we talking about a double-edged sword here? We have expressed concern over household debt, but then it's also potentially a downside to the economy. Can you align those, short term versus long term, and clarify a little further?

• (0900)

Mr. Mark Carney: You've hit on a key dynamic in the Canadian economy and a very influential element of the projection. Obviously, as you're well aware, the level of household debt has increased substantially. Most of this debt is backed by assets, an increase in value of real estate. We all—and particularly the bank—have to be aware of the possibility that there could be a negative dynamic that gets introduced into household spending if there is a sharper adjustment in the housing market than we anticipate, for whatever reason. It could be because of a shock from abroad. It could be because of other factors. If there were to be a sharper adjustment, given the level of debt that many households are carrying, that could cause a sharper contraction in household spending, or, at a minimum, a slower rate of growth of household spending.

Given, obviously, that consumption is more than 55% of GDP, it has a big knock-on effect on the prospects for the economy. We're very alert to that. As you say—you used the term “double-edged sword”—it's a fine balance in terms of the adjustment the government and CMHC have taken on the mortgage insurance rules; that OSFI has taken, in terms of their supervision of financial institutions, the quality of the underwriting standards; and obviously, the balance that the bank has to take within the context of its inflation target, in meeting its inflation target, in the setting of monetary policy, so that there is, as we've termed it, a constructive evolution of household finances.

I would say that as we sit here today, we are encouraged by the fact that the rate of debt accumulation has slowed. We see the prospect of stabilization this year of the debt-to-income ratio. We're encouraged by the fact that the level of housing starts has come down to slightly below demographic demand, as we see right now. There's still more adjustment to go. We're encouraged by the evolution of house prices in a number of markets.

We're on the path to a balanced evolution of the household sector. We all have to continue to be vigilant to the risks of both sides, the risk that this could re-accelerate and create more imbalances, more vulnerabilities for the future, and this risk on the downside that you just highlighted.

Mrs. Cathy McLeod: I'd now like to focus in a little bit on the skills shortage issue. I believe you addressed it last weekend. Of course we've taken some measures in the Canada job grant. Can you speak to how much of it is a skills shortage and how much of it relates to the mobility of the workforce? Maybe give some general comments in terms of the skills shortage we face, which I think we all recognize as an extraordinary problem.

Mr. Mark Carney: I think there are two aspects. The first is that we should recognize, from a starting point, that the Canadian labour market is one of the more flexible labour markets in the OECD. There is considerable job mobility across this country that has been demonstrated at times when there have been sharper differences in growth, for example, in recent years between the west and the eastern parts of the country. So there is a fair bit of flexibility in the market. As you're well aware, there are a variety of things that can continue to be done on the credentials side, another side, to improve that mobility. But we start from a relatively good position there.

The challenge we have, and that other advanced economies have, is that the pressure to upgrade skills is never ending. As the nature of production in the global economy continues to shift, the need for an advanced economy like Canada to continue to build skills to ensure that we are creating the jobs in the higher end of those global value chains is absolutely essential. There are some signs of skills mismatches. We do believe, as others do, that employers play an important role in ensuring that lifelong skills development is a part of the nature of business in Canada.

I'll stop there and we can come back.

● (0905)

The Chair: Thank you.

Thank you Ms. McLeod.

Mr. Brison, please.

Hon. Scott Brison (Kings—Hants, Lib.): Thank you, Mr. Chair, and thank you, Governor and Mr. Macklem, for appearing before us today.

There's been a lot of concern in Canada, fuelled by media speculation, about the comparison of the bail-in provisions in the most recent budget and those imposed in Cyprus. I think to reassure parliamentarians and Canadians, it would be helpful if you would define what the differences are, both in terms of the design of the proposed bail-in provisions here versus Cyprus and also the obvious differences between our banking systems.

Mr. Mark Carney: It's an important question. Let me begin by stating the obvious, but it's important to state the obvious. Financial institutions in Canada that are covered by deposit insurance—CDIC deposit insurance—are numerous, and that deposit insurance has the full faith and credit of the Canadian government. If anyone has any concerns about whether their institution is covered, www.CDIC.ca or www.SADC.ca is the way to check your institution. It's covered to \$100,000 by account and institution. There are several categories of accounts—individual, joint, TFSA, and RRSP are separate accounts, and trust accounts as well. There are quite comprehensive and considerable insured deposits in Canada. And for the vast majority of Canadians, they are covered by CDIC insurance, so this issue instantly goes away there.

On the second point, the situation in Cyprus, what happened there was that only the banks themselves were funded by deposits. That's number one. Number two, the Government of Cyprus did not have the resources and the backing of their deposit insurance scheme that the Canadian government, a triple-A government, does have. The uninsured deposits in Cyprus were ultimately “bailed in”, so uninsured depositors in Cyprus were taking losses. The Government of Canada, through the Minister of Finance's spokesperson, has said that all consumer deposits will not be subject to a bail-in regime. I will leave it to the government to come back with more details on the regime in due course. They signalled their intent to go in this direction; they can provide more details.

I'll make a general comment, from a global perspective, if I may, about the work that Mr. Macklem and I do through the FSB. In general, in advanced economies, banks are funded by insured deposits that are rock solid, as I just described. Then there are some uninsured deposits, and different countries can make different decisions about whether there is “deposit or preference” for those. To make it simple, they have unsecured debt, and then they have equity. The equity, if a bank gets in trouble, is obviously the first call. In a number of jurisdictions, that unsecured debt would be bailed in if a bank were really in trouble. It would become an equity holder; it would take losses. Different jurisdictions will do things differently. What's absolutely essential is that there is clarity, in advance, about the creditor hierarchy and what order different classes of funders of banks are bailed in.

It's also helpful to go back to the purpose behind all of this, and it's two-fold. First, it's to reduce systemic risk in the system. It ensures that there's clarity, as I say, and that there are adequate resources. If a bank makes mistakes, has big losses, gets itself into trouble, the private shareholders and the private creditors—the debt holders, not the depositors—bear the brunt of those losses, and obviously the management as well.

The second thing is that, in doing that, it brings discipline into the system. It brings capitalism to the heart of capitalism, if you will, in the banking system. It doesn't rely on the taxpayer to support the institution, as we have seen time and time again in the wake of the financial crisis.

● (0910)

The Chair: You have about 30 seconds, Mr. Brison.

Hon. Scott Brison: You've referred to, and spoken of, the less than robust level of business investment in Canada. Given the strong relationship between investment and productivity, is there a risk to long-term productivity in Canada? Secondly, what are some public policy measures for us to consider to address this?

Mr. Mark Carney: I'll only answer the first part; we can come back to the second part.

We review and update our view of productivity in Canada every October with the October report. There will be an update. The absence of strong investment does raise risk in terms of the rate of productivity growth, and that ultimately has implications for the conduct of monetary policy in the short term.

The Chair: Thank you, Mr. Brison.

Mr. Hoback, please.

Mr. Randy Hoback (Prince Albert, CPC): Thank you, Chair.

Welcome, Mr. Carney and Mr. Macklem.

You made a comment about shock from abroad and how it can impact the housing market. I wonder if you could elaborate on that and give Canadians an example of how shock from abroad can impact the housing market and how the impact on the housing market can also affect their household debt and their debt levels. I wonder if you could elaborate on that and tell us what this could mean to the individual Canadian.

Mr. Mark Carney: In effect, from a contextual perspective, Canadian debt to income is at an all-time high. Certain cohorts of Canadians are more vulnerable within those aggregate figures. By this I mean they have debt obligations that are above 40% of their post-tax income. That historically has been a level where you see step change in terms of their ability to service debts because of shocks. I'll try to avoid causing a shock, so I won't speculate on what exactly a shock could be, but it's something that materially lowers global economic growth. This could be events in emerging markets or events in one of the major economies. Materially lowered global economic growth has a flow-through impact on Canadian exports and has a knock-on impact on Canadian investment and hiring because businesses are uncertain. They also see less prospect for profit, so it has a knock-on effect that hits Canadian jobs.

Not surprisingly, one of the key indicators of heightened delinquencies on mortgages is employment. If you get a shock to unemployment, because we're an open economy and because of a reduction in global demand, you would have that knock-on impact. The challenge is if the impact is big enough, you can get a feedback to the housing market as well. More properties are on the market, fewer people are buying the properties. That hits the prices, that hits confidence on the margin, and there's less spending. These are recession-type dynamics, which are caused by a hypothetical larger shock. This is not our expectation in any respect, but we have to be conscious. All the parties involved, all the federal agencies involved, including the bank, have been quite conscious of this potential vulnerability over the course of the last few years, which is why we individually and collectively have taken steps to help manage the situation.

Mr. Randy Hoback: You also made a comment about the fact that two-thirds of floating rate mortgages are now converted to 10%. Does that offset that risk?

Mr. Mark Carney: It lowers the risk, without question.

Just so members are clear, that's a flow calculation. A year ago, two-thirds of people who went for mortgages went for floating rate mortgages. Now it's only 10%. Over the course of the last year, every month around 10% or 12% of mortgage applications have been fixed rate. Obviously there are advantages. If there were a shock that caused interest rates to go up, people with floating rate mortgages would be more exposed. Having mortgages fixed for five years reduces the vulnerability. On the margin it's a sensible thing for people to do if they have any concerns in that regard.

Mr. Randy Hoback: When you talk about debt-to-income ratios in this environment, what should a family look at? Would the Bank of Canada say it's a healthy debt-to-income ratio versus an unhealthy debt-to-income ratio?

Mr. Mark Carney: It's slightly a product of where they are in their life cycle.

As we all know, we all started out at one point, and you had to stretch a bit to take on a mortgage. It depends on whether both partners are working, or expect to work, and the security around those jobs. I hesitate a bit to be too prescriptive, to say there's a magic figure. Certainly once debt service starts to get up north of 40% of income, the weight of evidence is that delinquencies tend to go up.

We can provide some background to the committee, if it's of interest, and we've done some sensitivity analysis around this. You don't have much margin for error if your shifts get cut back or you have a child and you're out of the workforce for a bit—these types of things. When life intervenes, there's less of a margin for error, and individuals have to make judgments around that.

• (0915)

Mr. Randy Hoback: Thank you.

I'll stop there, Mr. Chair.

The Chair: Thank you, Mr. Hoback.

[Translation]

We will now turn to Mr. Caron.

Mr. Guy Caron (Rimouski-Neigette—Témiscouata—Les Basques, NDP): I would like to welcome Mr. Carney and Mr. Macklem.

I would like to go back to comments that you made last week regarding the possibility that the Bank of Canada may use interest rates to deal with household debt, and mortgage debt in particular. You commented on this possibility, but the next day, or shortly thereafter, you backtracked. I would like you to clarify the Bank of Canada's position on what action it may or may not take with respect to household debt.

I have a second question on the same topic. If taxes are the most effective tool that the Canadian government has to deal with household debt, particularly mortgage debt, should the government and the Minister of Finance be more aggressive and make it more difficult to be eligible for a mortgage, should you feel that this issue is still troubling or worrisome?

Mr. Mark Carney: I would like to answer your first question. I will turn the floor over to Mr. Macklem to answer the second one.

I feel that I was saying exactly the same thing. There are many factors that influence the Bank of Canada's monetary policy trend. If I had to choose three factors, I would say that, first of all, there is the pool of unused capacity, namely the surplus supply in Canada which remains at high levels right now. Secondly, there is the inflationary trend here in Canada. Thirdly, there is the evolution of household debt and the situation that exists in Canada in the mortgage and housing sectors.

Right now, we have a significant surplus of supply. Inflationary pressure is not significant. In addition, there has been constructive evolution in the household sector. As a result, it is clear that the considerable monetary easing that we see now in Canada will no doubt remain for a certain period of time. However, at one point, at a time that has not been identified by the Bank of Canada, it is likely that there will be a modest increase in the key policy rate.

As to your second question, I will let Mr. Macklem answer.

Mr. Tiff Macklem (Senior Deputy Governor, Bank of Canada): Thank you, yes. That is a good question.

Up until now, the steps taken by the government, OSFI and by us, through our upward bias with respect to our interest rates, have, all together, succeeded in reducing the activity rate in the household sector and the credit growth rate. I can give you a few significant figures.

For instance, last year we had approximately 225,000 housing starts; now, this figure has dropped to 185,000, according to our demographic demand estimate. These numbers have therefore fallen off slightly, after having been clearly high for some time. As for the resale sector, last year there were 480,000 units sold, and now the figure is 430,000, slightly below the average for the past 10 years. The growth rate of household credit is now approximately 4%. Last year, it was 6%, and before that, it was 10%. This rate has therefore dropped significantly.

As the Governor stated, this entire evolution is positive. It is not occurring too quickly, we do not see an acceleration. However, it is important to note that, in our opinion, even though the household debt-to-income ratio is about to stabilize, it is still relatively high. The same thing applies to the price of houses. So there are still some vulnerabilities. This gradual evolution must continue.

Going back to your question, I would say that it is too soon to drop our guard. If ever we see an acceleration, we will have to look at the measures that could be taken.

• (0920)

The Chair: All right, thank you.

Thank you, Mr. Caron.

[*English*]

Mr. Jean, please. It's your round.

Mr. Brian Jean (Fort McMurray—Athabasca, CPC): Thank you, Mr. Chair.

Thank you, both of you. I've enjoyed your testimony and the opportunity to listen to your questions over the past few years. I have found it very professional and educational, so thank you.

I want to talk about two particular issues that interest me. Of course, being from Fort McMurray, I'm interested in workers and the ability to keep the Canadian economy as strong as we possibly can. I am interested in the temporary foreign worker program as well as mobility.

I'll start with the mobility issue, because of course Canada does have a workforce that is very mobile, but we also have one of the highest air travel costs of many of the OECD countries. I'm interested in opportunities that present themselves for increasing the ability of Canadians to be mobile in a marketplace that allows for flexibility.

I travel to Fort McMurray pretty much every weekend. There are two direct flights from St. John's that I can catch a ride on in Toronto. It's amazing how many people I meet there who tell me that they can work in Fort McMurray for three or four months and make enough money such that they don't have to work the rest of the year at home; in fact, they say that amount of money is what they make at home.

The mobility issue is very, very important. Do you have any ideas on how we could increase mobility of Canadians for jobs?

Mr. Tiff Macklem: I'll make a couple of points. First of all, it's worth underlining that the mobility of Canadian workers has improved quite markedly over the last decade. We have some research done at the Bank of Canada that shows this, and we can share it with the committee. This has noticeably improved the efficiency of our labour markets. While there are still issues of matching workers with jobs and of skill gaps, the efficiency of the labour market is better than it was.

In other words, for every level there's a locus between unemployment and vacancies, and that is shifting to the origin, so that there are fewer unmatched jobs. A big part of this is due to improved mobility.

There are other elements to that matching. We've already talked about skills. That is an important element: making sure that the workers have the skills the employers need.

In terms of further improving mobility, there has been some progress, and there is room for more progress around accreditation. It's a case of having a labour market across Canada, in which particular workers in trades can move seamlessly across provincial boundaries—

• (0925)

Mr. Brian Jean: Is that the Red Seal program in particular?

Mr. Tiff Macklem: The Red Seal program is a good example.

So that is one area I would highlight.

You mentioned the temporary foreign worker program. The government is reviewing it. It is designed to deal with temporary skill gaps, and the intention is to bring workers in to fill those gaps on a temporary basis. It's important that it be used appropriately, and the government is reviewing that.

As a country, though, what we need to do wherever there are sustained skill gaps is invest in the country to generate those skills here in Canada, so that we have our own home-grown labour force.

Mr. Brian Jean: Would it be fair to say this especially of the high-end jobs—the highly skilled, highly trained, high-return-on-investment jobs?

Mr. Mark Carney: Yes, that's absolutely right. There can be short-term, and you're familiar with it... Mr. Macklem was just in Fort McMurray, and I'm from the area as well, so we're familiar with the kinds of gaps you get there. One doesn't want an over-reliance, certainly, on temporary foreign workers for lower-skilled jobs, which prevent the wage adjustment mechanism from making sure that Canadians are paid higher wages, but also so that firms improve their productivity as necessary. We don't want to mask it, and the intent of the government's review is to ensure that this is used for transition, for those higher-skilled gaps that exist and can hold our economy back.

Mr. Brian Jean: If that is the case, and if the program is working, let's say hypothetically, the way you describe it, how important is the temporary foreign worker program to keeping the economy rolling?

In Fort McMurray, for instance, I've never seen anyone earning more than \$20 or \$25 an hour who is a temporary foreign worker; such a case just doesn't exist. The average income there is \$185,000 per household—it's the highest in the country—and there is a huge service sector that is servicing the people working in the oil sands. Those people are not going to work for \$20 or \$25 an hour. So how important is it that we have a properly managed temporary foreign worker program, but also that we have one that works as you describe?

Mr. Mark Carney: I think the spirit of the program and the spirit of the government's review is to ensure that this program is concentrated on higher skills, number one, to fill gaps, and to recognize that those are temporary gaps, so that we are ensuring that Canadian businesses are providing Canadian solutions—the training—and that we're working together to ensure that Canadians can meet those gaps.

For the lower-wage jobs, it is important over a reasonable time period to ensure that the market adjusts and that those market wages adjust; then there will be productivity and other adjustments that ensure that Canadians are paid more, but also that we're a more productive economy as a whole. Getting that balance right is what is necessary.

The Chair: Thank you very much, and thank you, Mr. Jean.

[*Translation*]

Mr. Côté, you have the floor.

Mr. Raymond Côté (Beauport—Limoilou, NDP): Thank you, Mr. Chair.

I would like to thank both Mr. Macklem and Mr. Carney for joining us.

Mr. Carney, you will not remain in your position for much longer. I would like to congratulate you and thank you for bringing Canadian know-how elsewhere in the world. I really appreciate what you are doing, although I am sorry that we are going to be losing you for a few years. But that is another issue.

Governor Carney, I truly appreciated the comment you made at the end of your presentation when you talked about the current monetary easing, which is significant. That says a lot. I believe that your comment pertains to the particular situation that we are experiencing right now in Canada with respect to interest rates and all of the factors that have an impact on our economy.

I would like to discuss a particular topic with you, namely, the record levels of cash assets sitting in our Canadian businesses. According to a January 2013 analysis produced by the Royal Bank of Canada, this number is currently \$574 billion. Cash assets must now have grown considerably since then. It is interesting to see that, according to this analysis, this situation is explained by objective factors. I appreciate this point in particular as I am reading an economic essay written by Ms. Esther Duflo, who sits on a poverty panel advising the U.S. President. She looks at individual behaviour to explain certain consequences of objective decisions that are made.

Going back to the Royal Bank report, it looks at a range of factors, focusing on three important ones in particular, to explain this accumulation of cash assets, namely, uncertainty related to the international situation, deficits created by defined benefit pension funds, and changes within businesses to intangible assets, namely intellectual property. Businesses have changed a great deal. The knowledge-based economy has to a large extent replaced the production of yesterday. In your analysis, you say that we can be relatively optimistic about the ability of U.S. demand to help the recovery of the Canadian economy. You say that this could have an impact on current uncertainties, which would explain this accumulation of capital.

I would like you to talk about the pension fund deficits, and, in particular, the weak interest rates, which unfortunately offer few benefits. You have already made some comments on this issue.

How optimistic are you that we will see a rise in the key policy rate in the near future?

How will this help us deal with the deficit created by defined benefit pension funds?

• (0930)

Mr. Mark Carney: You ask a lot in your question.

With respect to the uncertainty of businesses and the impact that this has on their pace of investments, a box on pages 30 and 31 of the report shows the results of a Bank of Canada investigation. To some extent, the news is good. Indications are that the current situation is not so much about international uncertainty. This is not the case in Europe. The fiscal cliff in the United States is not a reason either. This was however, the case last summer. This is all good news. Furthermore, this is not about concerns with the Canadian financial system. Access to credit is not an issue.

The bad news is that this demonstrates uncertainty with respect to both Canadian and international demand. So once again you need an acceleration with respect to Canadian and American consumer demand. Banks are expecting this to occur.

As for the pension fund issue, this is in fact a difficult situation for them and this is caused by reduced interest rates everywhere in the world. To a certain extent, this is offset by an increase in other financial assets.

Mr. Raymond Côté: Have I used all of my time?

The Chair: Unfortunately, that is the case.

Mr. Raymond Côté: Thank you, Mr. Chair.

[*English*]

The Chair: Merci, Monsieur Côté.

We'll go to Mr. Adler, please.

Mr. Mark Adler (York Centre, CPC): Thank you, Chair.

Thank you, Governor and Deputy Governor, for being here this morning.

There are two issues I want to address during my line of questioning. The second one, which I'll mention first, is the investment accelerator. First, however, I want to talk about the implications for monetary policy in terms of the risks to the outlook. What are both the upside and downside to inflation? Could you just address that? Then we'll move on to the investment accelerator.

Mr. Mark Carney: The first thing is—and you know this, but for everyone's benefit—when the bank forms a projection, we try as much as possible to have a balanced projection. There are always upside and downside risks. Unfortunately, over the course of the last several years, those downside risks have felt heavier. So we try to adjust the base case so they're roughly balanced between the upside and the downside risk. As we sit here today, Ms. McLeod and others have talked about the housing risk, which is correct. Household spending can go both ways in Canada. We could see, on the upside, a reacceleration of household spending. We have seen that in the past, when tightening measures were taken in mortgage insurance. There was a period of adjustment and then a reacceleration. We don't think that is in prospect a sharp readjustment, but we have to be vigilant.

We could see also on the upside stronger export performance. One thing we haven't talked about yet this morning is that the Canadian export performance has been particularly weak relative to expectations. We can go into the details of why that is, but I'll simply say that we have held that weakness, if you will, over our projections. So we haven't had a return to the historic relationship between Canadian exports and foreign demand. That means there is an upside risk if things go back to the way they historically were. On the downside, of course, there could be weaker global demand because of events in Europe, impacts in the United States, and the flip side of the housing risk as well.

I'll let you ask your second question.

• (0935)

Mr. Mark Adler: Thank you.

My second question is on the investment accelerator. There are a number of reasons for uncertainty in the marketplace, and we all know businesses prefer certainty over uncertainty. Could you talk a bit about how that uncertainty was not generated domestically but more because of international reasons, global reasons, because of these headwinds that are generated outside of the country, not necessarily because of our own government's policy, and how investment, in terms of certainty...how businesses will not be parking the money any longer but will be more accommodating in spending it?

Mr. Mark Carney: As I said to Monsieur Côté, a year or so ago, and for a period of time before that, there was this impact of global uncertainty because of events in Europe, which were particularly fraught. There were fundamental uncertainties about U.S. fiscal policy and therefore U.S. demand, and those were weighing on Canadian businesses. Related to that was the sort of general policy uncertainty as well, policy in Europe, policy in the U.S., and to some extent monetary policy of global central banks as well as uncertainty about the effectiveness of that.

The effect of that on Canadians has dissipated because of steps taken in Europe and because—it's not perfect, but there have been steps taken in the U.S. as you are aware—of the relative effectiveness, particularly of the monetary policy of the Federal Reserve, which has been demonstrated.

So the uncertainties that exist right now for Canadian business have to do with global demand. There is some impact of two Canadian factors, though, which aren't policy related but are just part of the dynamics of demand in Canada. We've had weaker growth in

Canada than we would have expected and than businesses would have expected. So that accelerator you talk about is working, in that businesses are holding off—not totally holding off, but holding off until they see a pickup in domestic demand as well.

The other factor, which we highlight in the report, is the impact on the energy sector in Mr. Jean's region. It's page 15 *en français*, and I think it's page 15 in English as well. We see much higher volatility in Canadian crude. You know that; businesses know that. The level is also lower than WTI. So a lower level, higher volatility, and that sort of uncertainty on the margin, we think, are hitting investment in one of our most important sectors.

The Chair: Thank you.

Thank you, Mr. Adler.

Mr. Rankin, please, we will go to you.

Mr. Murray Rankin (Victoria, NDP): Thank you, Mr. Chair.

Thank you both for attending this morning.

I'm going to take you to a different place, if I may: the world of tax havens.

Governor Carney, you recently said that tax havens hurt the integrity of the global financial system and diminish the effectiveness of domestic fiscal policy.

Considering your experience on the Financial Stability Board in bringing non-cooperative jurisdictions into the fold, can you tell us what you consider to be the most effective instruments for contending with these jurisdictions? What are the best practices, or perhaps successful but under-studied measures, that the finance committee should know about?

Mr. Mark Carney: Thank you for that question, Mr. Rankin.

If I may, I'll start, and then I'm going to ask Mr. Macklem to supplement because he did some work, not on the tax aspect of non-cooperatives, but on the broader aspect of non-cooperative jurisdictions, at the FSB.

There is an initiative that is under way in the G-20. It was highlighted again this past weekend in Washington—and this is very much in the domain of the finance committee and the Minister of Finance—to enhance information exchange. That's one of the key elements of addressing this issue, to ensure there is appropriate, timely, and complete information exchange across jurisdictions, so that home jurisdictions can ensure their citizens, and their corporations, importantly, are paying their appropriate and fair share of tax.

The second element is that there is an OECD action plan that is being developed for the G-20—it's due in July of this year—to address the issue of so-called base shifting, and transfer pricing related to that, of corporations. This is with the big multinational corporations. They have become very effective in ensuring that costs are being booked in jurisdictions such as Canada and other G-7 countries and that revenue is being booked in low-tax jurisdictions, effectively ensuring that they pay relatively low levels of tax.

This is a global issue. Ideally, it will be tackled in a coordinated fashion by the major countries, because if one moves, then it becomes a competitiveness issue for them. At this stage I would say there is encouraging progress being made on both those facts, besides the information exchange and a more comprehensive plan. It is a tough issue, and I obviously defer very much to the committee and the minister.

Mr. Macklem can speak a bit to what's been done with non-cooperative jurisdictions more broadly.

● (0940)

Mr. Tiff Macklem: As the governor indicated, this isn't tax per se, but there's an analog. Just as people try to arbitrage the global tax system, financial institutions may try to arbitrage the global regulatory framework. As the FSB includes 27 countries, there has been a robust commitment and considerable progress to raising the standards of regulation and supervision in those countries. What we don't want is for other countries not to live up to those standards and then for those standards to get arbitrated.

As part of the FSB's initiative, there's an initiative to ensure that other countries are also living up to those standards. The principal way to do this, somewhat similar to the tax situation, is to get information exchange agreements. To make that concrete, suppose you're a securities regulator in Germany and you're overseeing a company that has activities in, say, an offshore financial centre somewhere else. What you need is an information exchange agreement with that offshore jurisdiction so that the securities regulator in Germany can get a line of sight to the company's activities in the offshore financial sector.

With the support of the IMF, and IOSCO, which is the international standards setter for securities regulators, there has been a robust effort to engage in these information exchange agreements. It's not perfect, but it is working, and a lot of these have been signed. The number of jurisdictions that are not cooperating is very low. By putting focus on this, countries have been brought to the table and they are getting on with it. They are signing those agreements, and that needs to continue.

Mr. Mark Carney: If I may add very briefly to this, what's important in the process that Mr. Macklem described is that it has to be coordinated across the major jurisdictions. There has to be development of a list of the jurisdictions that are most—let's be neutral on this—potentially problematic. There should be a sort of systematic addressing of that, and a reward, if you will, if you're a compliant jurisdiction versus a non-compliant jurisdiction.

Ultimately, those concepts need to be put in place in order to make steady progress on this. I'll leave it there.

The Chair: Thank you.

Thank you, Mr. Rankin.

Mr. Braid, please.

Mr. Peter Braid (Kitchener—Waterloo, CPC): Thank you very much, Mr. Chair.

It's great to be here today as part of this distinguished group at the finance committee.

Thank you, gentlemen, for your presentations today.

Mr. Carney, you describe the Canadian economy as being on a steady rise. You indicate that you project that we would return to full capacity by 2015, in about nine quarters.

Just for clarity, could you define “full capacity” for us?

● (0945)

Mr. Mark Carney: Let me say at the outset that there is some uncertainty about the exact level of capacity or potential in the economy, the level of the economy. But we do a variety of estimates, and then we at the governing council—Mr. Macklem, myself, and four deputy governors—use our judgment, on top of very statistical techniques, to both estimate the level of potential.... Currently we think the level of potential is about 1.25 percentage points above the level at which the Canadian economy is operating at present, so there's what we call a material output gap, a difference between the level at which we're operating and the level of the economy.

The other thing we very importantly have to estimate, and we update this every October, is the rate at which that level of potential grows: Canadians come into the workforce, they work additional hours, there's productivity growth. The sum of those two, the so-called labour input and productivity growth, is the rate of growth of potential in the economy.

Again, it's an estimate. Different people can have slightly different opinions. But it's very important for us to develop that estimate, because over time the difference between the level at which the economy is operating and the potential of the economy has an impact on inflation in Canada, and therefore we calibrate monetary policy appropriately.

Right now we see about a 1.25 percentage point difference between the level of potential and where the economy is operating. Our estimate, as of last year, which holds for today, is a 2.1 percentage point rate of potential growth.

In this quarter, the second quarter, we estimate that the Canadian economy will grow about 1.8 percentage points, but as of the third quarter and fourth quarter, the average of those two is about 2.5 percentage points of growth. So we would start to close that gap—just following the math—and have the impact.

Mr. Peter Braid: Great. Thank you.

Now, one of the ways to reach our full potential is to leverage and enhance current strengths of the Canadian economy. Could you elaborate, from your perspective, on what you think those current strengths of the Canadian economy are that we need to further leverage?

Mr. Mark Carney: There are two aspects to it. I'd answer it slightly differently, in the sense that there is unused potential, and it's a question of ensuring that we have the demand to close the gap. That demand takes various forms. Particularly important for our projection will be a pickup of business investment, and also gradually a pickup of exports.

I mentioned earlier to Mr. Adler that we have, in our view, a conservative forecast for exports in Canada relative to global demand, but that's based on some underperformance in the past.

So those are the two elements that would pick up on the demand side. But in reaching our full potential, I would almost change it slightly, I think, in the spirit of the question, which is that it's a question of further developing our potential.

We have a big demographic challenge in this country, an issue that this committee has studied in the past. We're at a phase where that contribution from labour input right now is about 0.7 to 0.8 percentage points of that 2.1. Five years back, it was about 1.5 percentage points of growth, because we were just that much younger as a population and the increase in participation of all strata of society was such....

What we need, in order to keep that speed limit up, is to grow productivity in this economy. That's going to take investment. That's going to take skills development. That's going to take flexibility of the Canadian labour market.

Our contribution at the bank to all of this is to deliver price stability and contribute to delivering financial stability so that all those good things can happen in an environment of relative certainty.

The Chair: You have time for one brief question, Mr. Braid.

Mr. Peter Braid: As my final and very brief question, you also mentioned, Mr. Carney, that the price gap between the U.S. and Canada is closing. What factors are driving that?

This is a good thing, of course.

Mr. Mark Carney: It is a good thing. The question is whether it's sustained. Obviously, we watch it closely, as others do, but it has moved down from the upper teens to just about south of 8%, which is our most recent figure on that.

There are a couple of factors, one importantly. The tariff adjustments make a difference on the margin. The competition has increased in the retail sector. There have been a number of foreign entrants that have increased competition. As a result, there has been an adjustment there, we think.

Another form of competition is cross-border shopping, which has gone up. I know that's not a favourite of Canadian retailers, but on the margin, that has adjusted the price gap as well.

We should say there are some factors in Canada that may mean we'll never fully close that price gap, given our geography, distribution costs, relatively higher wages, and other factors that we can get into if you wish.

• (0950)

The Chair: Thank you. Thank you, Mr. Braid.

We'll go to Ms. Glover, please, for your round.

Mrs. Shelly Glover (Saint Boniface, CPC): If you want to continue, please do.

Mr. Mark Carney: Okay.

One of the factors that has been important is the distribution system in Canada. MPs are probably more familiar than anybody with the breadth of the country and how spread out the major retail centres and smaller retail centres are in Canada. The ability to have concentrated distribution hubs that cover that breadth mean that on the margin the so-called economies of scale are not as big in Canada as they are in the United States.

The second factor is that our businesses use relatively more labour, and on balance that increases the cost; it's less productive, effectively. I should say as well that the Canadian retail sector, from a retail productivity perspective, is a fraction of the U.S. retail sector. Mr. Macklem can confirm this, but I think 70% is the level.

So we would expect to see over time, with greater competition, improvement in retail productivity. That creates opportunity for individuals to work in some of the higher-paying, higher-skilled jobs that Mr. Jean was talking about. These are some of the factors that we think will persist.

Mrs. Shelly Glover: I'm running out of time, unfortunately, and I want to get to what you said about tariffs.

As we all know, in the 1970s the general preferential tariff regime was started so that we could help the poorest of countries in the world to compete and grow. I note in your monetary policy report, on page 1 in fact, that China is listed over the next three years as having growth of 7.7%. Taking that into consideration, would you consider China as one of those poor countries that deserves a special tariff rate so they can compete with Canadian companies?

Mr. Mark Carney: Boy, there are a lot of ways I can go wrong answering that question, Ms. Glover.

Voices: Oh, oh!

Mr. Mark Carney: The reality of China...China is a study in contrasts. As you know, it's the second largest economy in the world now. Measured in market terms, that 7.7% is as big a contribution to the global economy in dollar terms as our forecast U.S. growth of 2%.

At the same time, China still has just under 300 million people who live in what would be described as poverty, and that is one of the factors that has allowed Chinese manufacturing enterprises to remain quite competitive. As those individuals move from the countryside—

Mrs. Shelly Glover: I am glad that you compared it to the U.S. because we don't give a special tax break to the U.S. either; they are not considered a poor country. Having said that, I was certainly glad to see that you've actually addressed in your monetary policy that China is doing better than most.

I do want to get to job recovery, because when you leave here... every time you appear and you address job recovery, someone goes out and says we haven't recovered all of the jobs since the recession. So would you repeat, for the last time perhaps, how Canada has fared with regard to jobs following the recession?

Mr. Mark Carney: Okay. These numbers get slightly revised over time, but the Canadian economy lost about 430,000 jobs in the recession, from the peak to the trough. We recovered all of those jobs. In fact, we've recovered the same amount again on top of that, so we've added the same amount again.

In terms of the jobs, the overall numbers, about three-quarters of the jobs are in industries that pay above-average wages. There is about the same percentage point in the private sector, and about 85%, on current figures, are full-time jobs.

We've recovered them all. We've added the same amount in the full-time private sector, and on the whole in above-average wage sectors.

As you're well aware, and this is important from a monetary policy perspective, there continues to be slack in the labour market. There are more Canadians out there who want to work. As well, the recovery in hours worked has not been as strong as the recovery of jobs. It's better that people are in work, but in a number of industries I think Canadians and businesses, if the demand were there, would work more hours.

Mrs. Shelly Glover: Very good.

• (0955)

The Chair: Thank you.

We will have time for more rounds.

Mrs. Shelly Glover: Okay. Thanks.

The Chair: Ms. Nash, please, for your second round.

Ms. Peggy Nash: Thank you, Mr. Chair.

Mr. Carney, I don't know if this is your last appearance before our committee, but I did want to thank you for your service to the people of Canada in your role as governor. I guess you've done such a good job that you've become a hot commodity in your own right. I do want to thank you for your role.

Of course, there has been a lot of speculation about who will replace you, so I have a couple of questions.

Mr. Macklem, there has been a lot of speculation that you will be the next Governor of the Bank of Canada. You certainly seem to be the front-runner. I have two questions.

The first is, if asked, will you serve? Are you interested in the job?

My second question is, can you describe what some of the challenges are following in the footsteps of Governor Carney?

Some hon. members: Oh, oh!

A voice: That's a little challenging.

Ms. Peggy Nash: I thought I'd give you an easy question.

The Chair: Don't worry—nobody's listening.

Voices: Oh, oh!

Mr. Tiff Macklem: How about I answer the first question?

The Chair: You can answer whatever you want to answer.

Mr. Tiff Macklem: Yes. If asked, I will serve.

There is a process that is ongoing. I don't think it would be appropriate for me to start answering interview questions here when there is a separate process. Respectfully, yes, if asked, I'll serve, but I will leave it there.

The Chair: [*Inaudible—Editor*]

Ms. Peggy Nash: Yes. Diplomacy, I think, is a qualification.

Let me return, then, to the issue of tariffs. The general preferential tariff, of course, applies not just to China but to 72 countries, included in which are countries like Gabon, Namibia, Dominican Republic, Grenada, Guam—many countries that don't have quite the growth rate of China.

I want to refer to a 2008 research paper from the Bank of Canada, which is discussing increasing tariffs on other countries. It concludes, and I'm quoting:

As regards the political dimension, we conclude that a “benevolent” policymaker would not adopt tariffs, because of negative long-term economic consequences, but “myopic” policymakers might be tempted to exploit short-term political gains.

I wonder if, in the light of that paper, you might have any views on the recent changes that would increase the tariffs on 72 countries with which Canada trades.

Mr. Mark Carney: I have not read the paper in question—now I'm going to have to.

I would say this, not having the benefit of having read it, that those terms are terms used in economic modelling, in game theoretic models. It depends in part on the objective function of the policy-maker as is modelled and the horizon over which they discount benefits and costs from any particular policy action.

The terminology is strong, but I suspect it relates to the nature of the theoretical construct of the model. But I haven't seen the paper, I'm afraid. I didn't write it.

• (1000)

Ms. Peggy Nash: It is a Bank of Canada paper.

Let me ask you, if tariffs increase on products that we do not manufacture here, what do you think would be the benefit to Canada in increasing tariffs on imported goods?

Mr. Mark Carney: Conceptually, by looking only at the benefits, there's a revenue benefit, obviously, and there is the potential, by changing the price of that product, that this product, which formerly wasn't manufactured here, would be manufactured here. Obviously, there is a wide range of costs, though, that would be associated with the policy.

Ms. Peggy Nash: If I hear you correctly, it might just be a revenue generator for the government.

Mr. Mark Carney: Well, I'm just speaking conceptually.

Ms. Peggy Nash: Thank you.

The Chair: Thank you.

Governor, I'll take the next round as the chair.

I want to give you the opportunity to comment on the rate at which banks lend to each other. On the Canadian dealer offered rate and the London interbank offered rate, the Investment Industry Regulatory Organization of Canada in January did a review. There have been some concerns raised at the international level with respect to some of the accountability in play and some of the aspects that have been happening by what they call LIBOR and CDOR. There have been questions raised with respect to whether they should be responsible to one outside regulatory body, rather than having a sort of private sector overseer.

Obviously, with your Canadian and international experience, I wanted to allow you an opportunity to comment on that.

Mr. Mark Carney: This is an important issue. It goes to several aspects of the financial system. First and foremost, and I'll speak generally about internationally, it goes to market integrity. We have seen what can only be described as some shocking criminal behaviour—we'll leave it to the courts to make those final determinations, and it's certainly behaviour that should be prosecuted to the full weight of not just securities regulators but also judicial authorities, as appropriate—in the manipulation of one of the most important financial benchmarks, or series of financial benchmarks, that are important to the functioning of the global financial system. That's the question of market integrity, and the oversight of that conduct is the responsibility of market regulators.

What has happened with financial benchmarks, and it's different in different jurisdictions, is that this, in many respects, has not been a regulated activity or an activity that has been overseen directly. What is changing is that the International Organization of Securities Commissions just came out with a series of recommendations last week for changing the governance and oversight of best practices for governance and oversight of these benchmarks. That's the first point.

The second point is that there are some questions—and the chairman of the CFTC raised questions yesterday even on this issue—about the ability of the so-called judgment-based benchmarks to continue to provide reliable indications of the underlying level of costs in transactions between banks.

The FSB, at the request of the G-20, will look into this issue in three respects: first, to ensure that those governance and oversight principles are put in place and they're followed by the member jurisdictions, which would include Canada, for CDOR; secondly, to consider what potential transaction-based benchmarks—so benchmarks that are based in real transactions as opposed to episodic transactions, and judgment around that—could eventually replace some of these, and I don't want to presume the outcome of that analysis; and thirdly, the transition mechanisms and potential transition costs associated with that.

I'll just make two final points.

LIBOR itself is a reference benchmark. It's an important benchmark. It's the costs of banks lending to each other. If you borrow as a corporation, often the cost of your funds is priced off LIBOR. Sometimes, in some countries, mortgages are priced off LIBOR. But LIBOR itself, on top of all that, is the reference benchmark in over \$300 trillion derivatives, so it's important that we get it right, and it's important that this is a seamless transition. That's the intent.

The last thing I'll say is that the official sector clearly has a role. We have a role to oversee and ensure integrity in these systems, but we also have a role to coordinate the private sector, and to allow the private sector to identify the next benchmarks and ensure an effective transition.

• (1005)

The Chair: I just have a short time left. Can you explain to Canadians—I understand it—why it matters to them very directly? Secondly, in your view, who or what should have oversight?

Mr. Mark Carney: I missed the first part of the question. I'm sorry, Chair.

The Chair: Why does the rate at which banks lend to each other matter to Canadians? Many people contact me and say they wonder why their rates don't fluctuate in accordance with the overnight rate that you set. But in fact the interbank lending rate has a much more direct impact.

Secondly, the most important question is, who or what, in your view, should have oversight, both domestically and at the international level?

Mr. Mark Carney: I think the answer to the second is for determination, but this is a market conduct question. Market conduct is best addressed by securities commissions; it's a market integrity issue.

My personal view is that ultimately we should come to an arrangement in Canada whereby this is overseen not by a self-regulatory organization, as it is at present by IIROC, but by one of the securities commissions. Obviously, that falls into all the joys of securities commissions and authorities and responsibilities that we have here in Canada.

The Chair: It falls, that is, into the question of whether we should have a common regulator.

I'll have to return to that, unfortunately. My time is up.

I'll go to Mr. Brison now, for your round, please.

Hon. Scott Brison: Thank you, Mr. Chair.

Governor, you've spoken of the financially vulnerable and those who are paying more than 40% of their income in debt servicing. Has the bank done some analysis as to how many Canadians fall into that category, how large the scale of that issue is, and secondly of the profile of these families? Are they middle class families who've had some disruption to their work, who may have lost full-time work and have gone into part-time work because of the decline in manufacturing? Or are they low-income families who have been strapped from the beginning?

What is the analysis the bank has done in this area?

Mr. Mark Carney: We have done some analysis. We have surveyed some databases that are representative of the Canadian economy. Obviously interest rates are incredibly low at present, both the Bank of Canada rate and the rates at which banks are lending to Canadians, and mortgage rates as well. The consequence is that you have to have a lot of debt relative to your income to be financially vulnerable.

The most recent analysis we did of this, which was probably six months ago for the December financial sector review, shows that at present around 8% of borrowers are in this category. We did some sensitivity analysis, some stress tests, around it, and the thing we've tried to show is what happens if interest rates start to move towards a more historic level—not very high levels, but more historic levels—and what happens if there's a shock, as we discussed earlier, that increases unemployment. Then we get up into numbers, such as that one in ten Canadians could be in that situation. Rates go up, and because of floating rate debt and repricing of debt—or unemployment as well, and at the same time, because often the two go together—and because the proportion of debt stock that's held by vulnerable households is slightly higher, we start to see that unhelpful dynamic.

We will share that analysis.

• (1010)

Mr. Tiff Macklem: The key point to keep in mind and to underline is that because interest rates are so low and delinquencies are relatively low, people are not having a huge problem servicing their debt. But with a bigger level of debt, when rates go up, the potential for that problem to rise more rapidly than it has historically is certainly there. That's a vulnerability, and that's what we've been trying to remind Canadians of.

Hon. Scott Brison: Would you agree that even fixed rate financing still carries with it significant risk? Five years is a fairly short period of time, and if Canadians are not able to reduce the size of their debts over that period of time, they will still be faced with the same challenge. Five years is just kicking it down the road.

Mr. Mark Carney: Without question, that's so. The only caveat, as you know, is that over that period there is some amortization of the underlying debt stock. But initially, with a mortgage, there's not much.

Hon. Scott Brison: In five years you could be back in Canada.

I was thinking of *Alice in Wonderland* earlier, and it's curiouser and curiouser. The Conservatives were defending higher tariffs and protectionism, and the NDP were arguing for lower tariffs and free trade, and there was the fascinating discussion you had with Ms. Glover about China and the comparison with the U.S. Do we not have a special tariff agreement with the U.S.? Isn't it called NAFTA?

Mr. Mark Carney: Yes, but I will leave it to you—

Hon. Scott Brison: That's what I thought. I just wanted to clarify for listeners.

Mr. Mark Carney: —to clarify the preciseness.

The Chair: Thirty seconds.

Hon. Scott Brison: Governor, thank you for your service to Canada. Do you have any advice to your successor based on what you learned?

Mr. Mark Carney: No. I was asked this question the other day, and I'm highly confident that my successor will be fully capable of discharging the responsibilities of the office and won't need my advice.

The Chair: Thank you, Mr. Brison.

One piece of advice: don't answer loaded questions at the finance committee.

Voices: Oh, oh!

Mr. Mark Carney: I think we've had a demonstration of how not to.

The Chair: Although we haven't had any today, obviously.

Mr. Jean, please.

Mr. Brian Jean: Thank you, Chair, and thank you for the opportunity to ask some more questions.

You mentioned, Mr. Carney, in relation to oil prices, just in passing, the difference between the Brent North Sea oil price and the Western Canadian Select. I know we've had this discussion generally before, but I don't think many Canadians realize, first of all, that we had the largest infrastructure investment in our history in Canada over the last five or six years by this particular government, some \$33 billion in infrastructure investment over a five-year period. This was somewhere in the neighbourhood of about \$3 billion or \$4 billion per year. And it's amazing that as a result of the spread last year there was somewhere in the neighbourhood of \$30 billion left on the table that wasn't captured by oil companies in Canada, because of the lack of transportation, the lack of infrastructure for pipelines, the inability for the rail to be able to be competitive on moving this oil. Ultimately, it has cost a lot of Canadian jobs, it's cost a lot of Canadian shareholders profits, and the reality is it has cost the federal government and the provincial governments a lot of money in tax revenues, etc. The federal government—many people don't know this—collects somewhere around 52% of the tax revenues from the oil sands.

How important is it for us to have new pipelines? It seems that even if we started today and all of them were approved, nothing would happen before 2015, and we're going to have this continual loss of \$30 billion per year to the shareholders and companies of Canada.

Mr. Mark Carney: Without question, it's an important issue.

Within the course of the past year we've had a very unusual situation in Canada. We had global oil prices go up, and normally that would be net positive for the Canadian economy. There's adjustment, but the flow-through effects, including through government, mean that higher energy prices globally are normally net positive for the Canadian economy. But in that specific situation with higher Brent prices, you had a big discount, so you had this revenue loss in western Canada, and because Brent is more relevant for the pricing of gas in eastern Canada, and central Canada to some extent, you had the loss in terms of disposable income, because higher gas prices outweighed what normally would have been a benefit on the revenue side. Fortunately, since then, the differential has narrowed somewhat, as you know, in recent weeks, but as I said earlier—and we put the data in there just to make this point—it's very volatile. It's a very volatile price because of these infrastructure difficulties you highlighted.

There is no question that there is a wide range of energy infrastructure projects—and obviously we don't favour specific projects or companies—that can benefit Canadian producers and Canadians as a whole, that can reduce at a minimum some of these differentials between high global prices of crude and lower prices received by Canadian producers so you can get gas prices down in eastern Canada, and that can provide an ability to supply reliable energy to the United States. I think one of the things—and we've made this point, but we should make it again—is that there has been an energy revolution in the U.S., and that's positive for the U.S. economy, but the prospect of energy security in the United States is still not within sight. There is North American energy security. In order to have North American energy security over time, there will need to be additional infrastructure investment, which will benefit both economies, but very importantly the Canadian economy as a whole.

• (1015)

Mr. Brian Jean: With what's going on with the United States and their desire to become oil independent, what's going on in Canada with our lack of capacity? Can you identify anything more important for governments in Canada to concentrate on that would give us the low-hanging fruit of profitability for the health of the Canadian economy in this particular case? Is there anything more important than working on this and finding a solution for capacity constraints and the limit of customers?

Mr. Mark Carney: Within the energy complex as a whole, without question Canada needs to develop additional transportation infrastructure. I'll leave it for others to make the judgment about different sectors of the economy.

Mr. Brian Jean: In fact, the timing of this is absolutely critical. I know we have the constraints and we have a long-term problem here. But if we don't tackle it immediately, it's going to become a bigger and bigger problem, based on the growth in demand for oil, not just in the U.S. but in the world.

Mr. Mark Carney: Yes, it is an important issue. As you know, a number of levels of government and private sector entities are seized of this, to the benefit of all.

The Chair: Thank you, Mr. Jean.

Monsieur Caron.

[Translation]

Mr. Guy Caron: Thank you very much, Mr. Chair.

I would like to broach an issue that has not been discussed today and is something we have not talked about for quite some time. I refer to derivative products. You are also the Chair of the Financial Stability Board for the G20. When I think about the work that I did in this sector back in 2007, 2008 and 2009, I still keep hearing the words

[English]

credit default swap and asset-backed commercial paper

[Translation]

Nevertheless, we have the impression that this is no longer a priority issue, even though this was what caused the crisis that we experienced and that we are still experiencing. First of all, where do the discussions stand at present? What work has been done by the board and the G20 countries in this sector? Do you feel that the Government of Canada, like the rest of the G7 countries, should be making more efforts to deal with this matter?

Also, I would like to hear your thoughts about an even more problematic situation, namely over-the-counter transactions. This issue appears to be one of your concerns, according to a report published by the Bank of France.

Mr. Mark Carney: Thank you very much. You are right, as usual. These are extremely important issues for the financial stability of both the world and Canada.

With respect to asset-backed commercial papers, I believe that reforms have been made in the area of standards and security rules for securitization. These reforms will probably take place in a few months time in

[English]

money market funds

[Translation]

because they represented the largest investors in such products. To some extent, they no longer pose a problem to financial stability. Nevertheless, over-the-counter products do still represent a tremendous problem for the system. We must continue pursuing the reforms that we started implementing a few years ago.

• (1020)

[English]

May I switch to English?

There are three aspects here.

Very quickly, there's transparency where there's been a lot of progress. Canada is in the process of setting up a trade repository. That will help with transparency. In my role at the FSB we've written to all FSB members to ensure they all do the same thing. That's the first point.

The second point is how these products are cleared. The plumbing of the system takes out a lot of risk. There's something called the central counterparty, which ensures that instead of the relationship being directly bilateral between two institutions, it has a central counterparty that ensures that if one of those institutions fails, the other institution can keep going. The Canadian authorities, federal and provincial, have taken a decision to centralize Canadian derivatives-clearing in London for interest rate swaps. This is a hugely important decision, and it will substantially reduce the risk from that in a very efficient way for Canadian institutions.

The third point is a series of rules that regulate cross-border derivatives. If it's a trade between an institution in Montreal and an institution in Europe, two sets of rules potentially apply to that transaction. We need to harmonize those rules to ensure the transactions can be in place. There have been a series of meetings to ensure that. Canadian authorities,

[*Translation*]

The financial market authorities and
[*English*]

the Ontario Securities Commission, have been involved in those meetings. Through the FSB we're helping to push that along. We had a series of meetings over the course of this past weekend to ensure that meaningful progress is being made on this front. We're trying to bring a number of these reforms to a head by the St. Petersburg G-20 summit in September.

I'd say there's meaningful progress. I would welcome the continued interest of this committee in this issue. It's very complicated, but all the pieces of the reforms have to be put in place for the true, large elements of risk to be substantially reduced in this important market.

[*Translation*]

Mr. Guy Caron: My last question will be brief.

We have talked about a sole regulator in Canada. The debate is still ongoing. Currently, we have a passport system for the provinces, excluding Ontario. What is your assessment of the current passport system for the provincial regulators?

Mr. Mark Carney: That is a very sensitive issue.

As far as the Bank of Canada is concerned, under the current system, we work very closely with the provincial authorities, the Office of the Superintendent of Financial Institutions, the Federal Department of Finance and all of the other agencies in order to implement reforms like the ones I just described for the derivative product market.

[*English*]

The Chair: I'll go to Mr. Braid and Mr. Hoback, please.

Mr. Braid, please go first.

Mr. Peter Braid: Thank you, Mr. Chair.

I'll share my time with Mr. Hoback.

Particularly as a guest today I would dare not ever politicize the role of the Bank of Canada or of the hiring process to replace the governor. You can both be relieved; I won't go there.

I have a question about the situation in the U.S. It's clear that the U.S. needs to get their fiscal house in order. That's probably the classic understatement of the day today. There's some concern perhaps about the way they're going about that. I'm thinking specifically about sequestration. I was in Washington a couple of weeks ago, and that's all I heard about when I was there. I know you were there recently as well, Mr. Carney.

I'm curious about your thoughts on that. Is sequestration a potential risk factor for Canada and for the Canadian economy in contrast to the U.S. approach to budget cuts, for instance, this automatic meat cleaver approach to the plans and prudent approach of the Canadian government to restrain the cost of government and reduce the size of government?

Could you speak to that?

• (1025)

Mr. Mark Carney: Let me say a few things. It's a very important question.

Let's be upfront about sequestration. The idea behind sequestration was to create a series of cuts that were so foolish that they would cause U.S. authorities to come to a sensible budget agreement. Well, they didn't come to a sensible budget agreement, and now a series of foolish cuts—punitive cuts, in some respects—are starting to roll out.

We're only starting to see them. For example, in the last few days the reduction in air traffic control hours has started to roll out, with some consequences there. Canadians are potentially going to have this impact on border guards, customs officials in the United States, who do an excellent job, but if you reduce the number of them, there are potential delays there. There is a series of other aspects like this.

Our estimate of the impact of sequestration is that the U.S. economy...it will reduce growth in the United States by about 1.08 percentage points this year. That's the entirety of the U.S. package. I shouldn't say that's all sequestration, but it includes the budget deal on the tax side, the Bush tax cuts and other factors. So it's a 1.08% fiscal drag on the U.S. this year.

We have a 2% growth projection for the United States, given all of that, in 2013. To look at the other side, this gives you a sense of how much the private side has improved in the United States. If the government weren't doing this, it would be almost four percentage points of growth.

We have a front-loaded fiscal adjustment in the United States this year. Next year we see just under one percentage point, specifically 0.8% fiscal drag in the United States, and as a consequence we see higher growth in the U.S., around 3%.

It's an important issue. The U.S. needs to adjust. As you say, it needs to make long-term adjustments, but these are designed to be foolish, short-term adjustments that don't ultimately deliver a path for that longer-term adjuster, which will take some tough decisions, as the American administration knows, on entitlements and other factors—potentially revenue. It's an unfortunate set of events.

That said, from an underlying strength in the U.S. economy perspective, we see the strength in the private sector moving through this. The U.S. economy is still growing at 2% with associated demand for Canadian goods and services, albeit with some friction costs in terms of travel and getting across the border.

Mr. Tiff Macklem: I'll simply add that our exports are more exposed to U.S. private demand than they are to U.S. government spending on goods and services. Sequestration, clearly, if it creates delays at the border, could affect our exports. But the recovery we're seeing in the U.S. housing sector—and we highlight this in our report. We are really seeing the consequences of that for our lumber industry, and we'll also increasingly see it for higher pieces in the value chain, windows and doors, that sort of thing. So it's the private demand that's key for our exports.

The Chair: Thank you.

Mr. Hoback, you're out of time, but we may well come back to you after the next round.

[*Translation*]

Mr. Côté, you have five minutes.

Mr. Raymond Côté: Thank you very much, Mr. Chair.

Mr. Carney, we discussed the cash assets of businesses and the pension fund challenge, but I think that you wanted to add something to what you said. Do you recall what you wanted to add at the end of your reply?

Mr. Mark Carney: Yes, I wanted to point out that this situation is difficult here, in Canada, and in the other advanced economies. There is indeed a problem with defined benefits. Companies need to save and invest money in pension funds. Companies cannot invest in their own businesses. Obviously, this poses a problem. There are several factors involved. There is the bank rate. The Government of Canada implemented reforms that mitigated this effect with

[*English*]

letters of credit in smoothing the discount rate.

• (1030)

[*Translation*]

There is also a positive aspect related to the easing of monetary policy in the United States. This stimulated monetary policy, such as the one here in Canada. The value of pension shares and bonds has increased.

To some extent, some aspects tend to balance the situation, but of course it remains difficult.

Mr. Raymond Côté: I would like to hear your thoughts on unused capacity in the Canadian economy.

As the MP for Beauport—Limouilou, I am very proud to represent a region where there has been a high rate of economic activity. The unemployment rate is standing at 5% to 6% whereas 20 years ago, when I left university with my degree in hand, the unemployment rate was about 11% or 12%. This was a very difficult situation. The current situation is the result of the public, parapublic and private sectors mobilizing and deciding to invest in the future and in innovation.

We saw some very wonderful examples at the Mercuriades Gala, with, for example, the TeraXion company which does business throughout the world. In fact, this company hardly does any business here in Canada.

I will not conceal the fact that I am dismayed that we are, to some extent, relying heavily on recovery occurring in other countries. I feel that we should be relying more on ourselves, but this is probably due to my being proud. At any rate, this all remains to be seen.

Could you tell me what you think, first of all, about my pride problem, and then about what means we could use to tap into this unused capacity in Canada to help the Canadian economy?

Mr. Mark Carney: That is a good question. I will start to answer and I will then let Mr. Macklem continue.

The cost of obtaining a university degree in Canada is about 40%. The average in OECD countries is approximately 50%. So that is one aspect of this issue,

[*English*]

the skills, the mismatch

[*Translation*]

which currently exists in Canada.

This is not so much about pride, but rather we need to undertake reforms in Canada that will benefit all Canadians.

Mr. Macklem, the floor is yours.

Mr. Tiff Macklem: Indeed, we share this opinion. Global recovery is important in order to increase demand for exports. So that is one aspect leading to the recovery in Canada.

Over the past two quarters last year, we saw weak exports in Canada. However, this situation will improve once there is a global recovery.

The other aspect that we need to improve is the competitiveness of our exports. This requires greater investment and more development of other markets. We are very focused on the United States. This served us well for a long time, but now we need to do business elsewhere. We should turn to emerging countries that are developing more quickly.

So we should find these markets and invest in them.

The Chair: Thank you.

Mr. Raymond Côté: Thank you very much, Mr. Chair.

[*English*]

The Chair: Mr. Hoback, please.

Mr. Randy Hoback: I just want to set the record straight, Mr. Carney, with regard to the difference between general preferential tariffs and agreements like NAFTA. When you have a general preferential tariff, what kind of market access do Canadian companies get into that country that we have the tariff with?

•(1035)

Mr. Mark Carney: The GPT would be a unilateral reduction of Canadian tariffs for those countries that are vested under it, whereas NAFTA, the free trade agreement before NAFTA, potentially a European free trade agreement, as examples, would be reciprocal.

Mr. Randy Hoback: Yes, so that market access is equal on both sides.

Mr. Mark Carney: Absolutely.

Mr. Randy Hoback: The playing field is what one might call level. It's a level playing field.

Mr. Mark Carney: Yes.

Mr. Randy Hoback: So it's access to markets, battle it out, whereas in a provincial tariff that's not the case, of course.

I know the NDP say it's a tariff. They keep on talking about it as a revenue generator. In reality, maybe they're right. It is a revenue generator, because you're creating jobs and economic activity in Canada and employing people, and that indirectly does create revenues.

Which is the better type of revenue to create, the jobs, the manufacturing jobs, or...? I guess I'll leave that up to you.

Mr. Mark Carney: What was that about not answering loaded questions?

Obviously, we don't have a view about the specific issue that members are debating. From a monetary policy perspective, adjustments in tariff rates, whether they're up or down, in a regime such as Canada where there's a credible inflation target, cause a one-time adjustment in the price level, up or down depending on where the tariff goes. In many cases, it's a very marginal adjustment.

Even if it's a slightly bigger and noticeable adjustment, that is a momentary increase in the price level that doesn't build into the rate of inflation over time. So in the conduct of monetary policy, we look through that. If tariffs were reduced, we look through that, and we don't expect there would be a continuation of lower inflation as a result.

Mr. Randy Hoback: From an inflation point of view, I can see what you're saying, but from a jobs creation point of view—a manufacturing jobs creation point of view—putting these preferential tariffs back in place, which should have been taken off 20 years ago, effectively puts in a level playing field for Canadian companies that are producing the same goods, level with a company in a country that had preferential tariffs and no longer deserves that preferential status. Is that fair to say?

Mr. Mark Carney: That could be the case, but I'm not following the details of the debate. I understand what you're saying, but I'm not....

Mr. Randy Hoback: One thing about the changes we make in preferential tariffs is that we level the playing field again with a tariff, because they have a tariff on our goods going into that country. With NAFTA, when we take the tariffs away, we have a level playing field. In a situation where you have a preferential tariff, you have actually created an uneven field against Canadian companies. We do that based on other reasons. When you look at this situation, we're actually levelling the playing field and giving Canadian

companies the opportunity to compete on an equal footing with the competing companies from other countries.

Mr. Mark Carney: I'll speak in a general way. Free trade agreements are reciprocal. Tariff policy, absent multilateral agreements, which are also reciprocal in their overall design, is unilateral. There are sometimes arguments for what you're saying, as there are sometimes arguments on the other side, depending on the industry, the time, the competitive situation globally, whether it's an end product, or whether it's an input. There's a variety of factors that determine trade policy, and I'll leave trade policy to the experts who design these things.

Mr. Randy Hoback: I think you'd probably agree that it's better to have a good trade agreement, like a NAFTA agreement or an FTA with Europe. That would be the preferential outcome of any type of agreement.

Mr. Mark Carney: First, our analysis has been that Canada has benefited tremendously from the agreements you referenced. NAFTA is one example.

Second, as Mr. Macklem just highlighted, there is a broader need for Canadian exporters to diversify internationally in an aggressive trade strategy, which could include the European Free Trade Agreement, and which could include the TPP, the Asian-focused initiative. Other bilateral trade agreements would very much, in our view, help that diversification process, which would make the Canadian economy more resilient, creating more income and more jobs over time in the Canadian economy. I will not go into the specifics of any of those agreements, but directionally speaking, that strategy is very much to the benefit of addressing some of the basic challenges faced by the Canadian economy, businesses, and workers.

•(1040)

Mr. Randy Hoback: I think I'll end on that positive note.

The Chair: Okay, thank you.

I have some further questions, but Governor Carney asked for a few minutes at the end of the meeting, so I want to turn the floor back to him before I wrap up the meeting to give him time to offer some concluding remarks.

Mr. Mark Carney: On behalf of Mr. Macklem, myself, and previous governors, senior deputy governors, I want to underscore how valuable these meetings are for the bank. As I said at the start, this is an essential part of our accountability to Parliament, our accountability to Canadians. We greatly appreciate it. It's not always pleasant, but it is absolutely right and appropriate and necessary to be asked pointed questions about our forecast, about the dynamics of the Canadian economy, and about the risks in the financial sector. We appreciate it.

I think one thing I can safely say is that it is difficult to be an MP. You don't get a lot of praise or thanks, so I wanted to take this opportunity to thank you for the work that you all put in, on behalf of your constituents and Canadians, in holding the bank to account and ensuring that, to the extent possible, our fellow citizens understand our view of the economy, the prospects, and the risks for our country.

Thank you.

The Chair: Thank you very much, Governor Carney.

On behalf of all committee members here, I want to thank you so much for your service to our country, and for your very respectful, substantive dialogue at all times, at all appearances before our committee.

[*Translation*]

On behalf of all committee members, thank you very much.

[*English*]

Thank you so much for your service.

At the last session I asked you who your favourite football team was, and I don't know if I got you in trouble.

I'm here at the final meeting to deliver a gift from your favourite hockey team, the Edmonton Oilers. I'm going to wrap up the meeting and then I'm going to present you with a little gift. I'm just delivering it; it's on behalf of Patrick LaForge and Kevin Lowe, two very good friends of yours.

Thank you so much, Mr. Carney and Mr. Macklem, for being here today.

Mr. Mark Carney: Thank you very much.

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